My name is Reem Fahey. I am the Division Vice President of Market Policy for Edison Mission Energy. It's a pleasure to be here and thank you for inviting me.

Edison Mission Energy owns or controls approximately 7,500 MWs of coal-fired base-loaded units in PJM. Such units provide energy, capacity, ancillary services and support the overall reliability of the PJM system.

I would like to focus my remarks today on two principal market design features that should be a component of any contemplated PJM capacity market construct.

The first critical design feature should be the inclusion of a demand curve. The principal benefit of a demand curve is that it allows for a variable reserve requirement that will provide a more robust incentive for generation investment. The demand curve recognizes the value of additional resources above the minimum reserve requirement and provides benefits to suppliers and load. Suppliers benefit from a more stable and predictable revenue stream coming from the value of excess reserves. On the other hand, load benefits from increased reliability and reduced exposure to price spikes in the capacity and energy markets. The design of the curve can also reduce suppliers' potential to exercise market power because it reduces the excess revenues that may result when shortages are created by withholding capacity.

If reserve levels fall below the threshold of the industry standard - Loss of Load Probability of one day in 10 years - the pricing factor would increase to encourage generation investment to resolve the shortage. When the threshold is reached, the pricing factor would ramp off slowly to recognize the value of higher generation reserve levels. This leads to stable ICAP revenue which will reduce the risk and cost of financing investment in new generation capacity and thus reduce the cost of electricity to consumers in the long term.

A major market design flaw in the current PJM capacity market is the use of a vertical demand curve. The vertical demand curve sets the capacity obligation based on a single value. The consequence is that prices can be very low when a small supply excess exists and can suddenly jump very high with a modest downward change in the supply availability. The highly volatile prices produced by the current PJM capacity market discourage the development of new generation and undervalues the reliability benefits of existing generation. This type of pricing behavior tends to convey contradictory investment signals and leads to boom-bust cycles of generation development.

From a policy perspective, EME believes that the inclusion of the demand curve in the capacity market has already been vetted and carefully considered by FERC for both NYISO and New England capacity markets. FERC's order regarding the NYISO's demand curve has been affirmed on appeal, so FERC's authority to adopt such an element of a capacity market has already been upheld.

The second principal design feature of a properly structured capacity market is the establishment of a forward capacity obligation for all load-serving entities.

A forward capacity obligation sends a long-term price signal that should provide the market with a greater opportunity to determine the most cost-efficient solution – generation, demand side, or transmission –in order to maintain the reliability of the system.

EME believes that a minimum of a four-year forward commitment is necessary to allow new generation to enter the market well in advance of when the capacity is actually needed for system reliability. It also allows existing generators to make informed decisions about incremental investment or unit retirements. Advance capacity sales by generators may improve creditworthiness of merchant generation owners, making it less costly and easier to finance plant expansion and construction of new plants.

In addition, a four-year forward commitment benefits load serving entities as well because it facilitates a more robust and cost effective Transmission Planning process and mitigates the need for Reliability Must Run (RMR) contracts.

I would like to conclude by commending the thoughtful and complete job the PJM Staff has done in developing and improving, with unprecedented stakeholder input, the current RPM proposal. Prior history makes it abundantly clear, however, that the stakeholder process has run its course. Further debate at that level will not resolve the issues that remain. These issues require Commission's process to address the economic considerations in light of the long-term reliability concerns. Now is the time to file the RPM capacity market proposal with FERC so that it can be implemented by the Summer of 2006.

Thank you again for the opportunity to speak. I look forward to further debate on the issues during the Q&A portion of this panel discussion.